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VIA ELECTRONIC SUBMISSION (PDF)

Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Proposed Rulemaking: Conflicts and Affiliations (91 Fed. Reg. 50926 | RIN 3038-AF76)

Dear Mr. Kirkpatrick:

Sporttrade Inc. ("Sporttrade") appreciates the opportunity to submit this comment letter in response to the Commodity Futures Trading Commission's ("CFTC" or "Commission") Notice of Proposed Rulemaking regarding *Conflicts and Affiliations* (RIN 3038-AF76) (the "Proposed Rule").[1]

Sporttrade is an applicant for registration as both a Designated Contract Market ("DCM") and a Derivatives Clearing Organization ("DCO"). Founded in 2018, Sporttrade's core mission is to apply sophisticated electronic market principles to trading in a manner that unyieldingly puts the market participant first. Sporttrade occupies a unique position in this ecosystem: we are the only operator that has actually run a live, exchange-like market structure under state regulatory jurisdiction—where participants traded against one another rather than against a house bookmaker—before exiting state frameworks due to the fundamental incompatibility between open exchange models and rigid, player-versus-house sportsbook rules.

In our prior public comment submission to the Commission regarding *Prediction Markets; Public Interest Determinations* (RIN 3038-AF65), dated July 27, 2026, Sporttrade specifically alerted the Commission to **the structural threat of single-dealer "sportsbooks" operating via vertical integration**.[2] We noted that when a commercial enterprise vertically integrates a futures commission merchant ("FCM"),

[1] Conflicts and Affiliations, 91 Fed. Reg. 50926 (Aug. 6, 2026), *available at* https://www.govinfo.gov/content/pkg/FR-2026-08-06/pdf/2026-15948.pdf.
[2] Sporttrade Inc., Comment Letter on Proposed Rule on Prediction Markets; Public Interest Determinations (July 27, 2026), *available at* https://www.regulations.gov/comment/CFTC-2026-1189-1203.

DCM, DCO, and an affiliated market maker, it can structure fee schedules and clearing economics such that only its own affiliated market maker can commercially survive.

We write today to address RIN 3038-AF76 directly. While the Commission's behavioral guardrails in proposed 17 C.F.R. § 38.852—including order-priority subordination, incentive parity, independent verification, and point-of-transaction disclosures[3]—represent well-intentioned efforts, they fail to address a simple, fatal economic loophole: the potential for exchange fee arbitrage.

Without a strict structural ownership limitation, behavioral rules cannot prevent a vertically integrated DCM from using its exchange fee schedule as an economic moat to drive out independent liquidity providers. This dynamic directly distorts the statutory intent of the Commodity Exchange Act ("CEA"), transforming what Congress mandated to be an open, competitive **"Board of Trade"**[4] into a closed, single-dealer platform—an unlicensed house sportsbook disguised as a federally regulated exchange.

Below, we draw upon our operational experience to demonstrate why the proposed behavioral guardrails are ineffective against fee-schedule manipulation and reiterate our recommendation for a clean, self-enforcing structural solution: **a mandatory 20% cap on a DCM's direct or indirect ownership of any market-making entity trading on its venue.**[5]

I. STATUTORY INTENT: THE CEA MANDATES A MULTILATERAL BOARD OF TRADE, NOT A CLOSED SPORTSBOOK

A. The CEA's Pro-Competition Purpose

Under CEA Section 3(b), Congress established that the purpose of the Act is to serve the public interest through a system of effective self-regulation of trading facilities and to foster fair competition among boards of trade and market participants.[6] The Commission itself has invoked Section 3(b) as the statutory foundation for the Proposed Rule, explaining that affiliations between trading facilities and the participants that trade on them raise questions about the quality of self-regulatory oversight and conflicts of interest.[7] The Commission has also stated that facilitating market-structure innovation and competition, subject to appropriate safeguards, advances its mission.[8]

DCM Core Principle 9 requires a contract market to provide a *"competitive, open, and efficient market and a mechanism for executing transactions that protects the price*

[3] 91 Fed. Reg. at 50950-54.
[4] 7 U.S.C. § 5(b) (stating that a purpose of the CEA is to "promote responsible innovation and fair competition among boards of trade, other markets and market participants."); 7 U.S.C. § 7(d)(9) (providing that the board of trade shall provide a "competitive, open, and efficient market.").
[5] Sporttrade Inc., Comment Letter on Proposed Rule on Prediction Markets; Public Interest Determinations, *supra* note 2.
[6] 7 U.S.C. § 5(b).
[7] 91 Fed. Reg. at 50927-28.
[8] *Id.* at 50927.

discovery process,"[9] while DCM Core Principle 16 mandates rules to *"minimize conflicts of interest in the decision-making process."*[10] As the Proposed Rule recognizes, Core Principle 16 directs DCMs to be particularly vigilant for conflicts between their self-regulatory responsibilities and their commercial interests, including the interests of their owners.[11]

Congress also directed the Commission, in administering the CEA, to take into consideration the public interest protected by the antitrust laws and to endeavor to take the least anticompetitive means of achieving the CEA's objectives.[12] Read together, these provisions point in one direction: a DCM is meant to be a venue in which independent participants compete on equal terms to provide liquidity, not one in which the operator's own corporate group is the only participant that can afford to do so.

B. A Board of Trade Is Not a Sportsbook

As Sporttrade highlighted in its July 2026 comment letter, a fundamental, irreconcilable distinction exists between a **multilateral exchange (a Board of Trade)** and a **single-dealer platform (a Sportsbook)**:[13]

- **A Board of Trade** is an open, competitive venue where independent market participants, institutional liquidity providers, and retail traders compete on equal terms to establish transparent market pricing through order-book competition.[14]

- **A Sportsbook** is a single-dealer model where the operator (or its 100%-owned affiliate) acts as the sole, perpetual counterparty to every customer trade, extracting a house edge through wide bid-ask spreads and prohibitive fee barriers.[15]

When a DCM is structured such that its 100%-owned market maker is the only entity that can economically afford to quote tight spreads on the exchange, **the DCM ceases**

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[9] 7 U.S.C. § 7(d)(9).
[10] 7 U.S.C. § 7(d)(16).
[11] 91 Fed. Reg. at 50928 (citing Core Principle 16).
[12] 7 U.S.C. § 19(b).
[13] Sporttrade Inc., Comment Letter on Proposed Rule on Prediction Markets; Public Interest Determinations, *supra* note 2.
[14] 7 U.S.C. § 1a(6) (providing that a board of trade is "any organized exchange or other trading facility."); 7 U.S.C. § 1a(51)(A) (stating that a "trading facility" is a system in which multiple participants can trade "by accepting bids or offers made by other participants that are open to multiple participants."); 7 U.S.C. § 7(d)(9) (boards of trade must "provide a competitive, open, and efficient market and mechanism for executing transactions").
[15] *See* Caitlin Vanderkarr and Eric Kintner, *Event Contracts Versus Sportsbooks: Charting the Legal Divide in U.S. Gambling Law* (Apr. 30, 2025), https://www.swlaw.com/publication/event-contracts-versus-sportsbooks-charting-the-legal-divide-in-u-s-gambling-law/; *see generally* Steven D. Levitt, *Why Are Gambling Markets Organised So Differently from Financial Markets?*, 114 Econ. J. 223 (2004) (describing the bookmaker model, in which the bookmaker sets prices, earns a margin on volume, and takes positions against bettors, in contrast to prices formed by competing orders).

to function as a Board of Trade. It degrades into a single-dealer sportsbook operating under the regulatory cloak of a CFTC-designated exchange.

As the Commission observed in the Proposed Rule, the affiliated-market-maker structure is particularly prominent in prediction markets: approximately eight of the 27 currently designated DCMs have affiliated market makers.[16] If that structure is permitted to mature without addressing the inherent conflicts created by this structure, the dominant form of a fast-growing category of DCMs may functionally be a single-dealer sportsbook.

II. THE FEE SCHEDULE ARBITRAGE: WHY THE PROPOSED § 38.852 BEHAVIORAL GUARDRAILS SHOULD BE ENHANCED

A. The Proposed Framework

Proposed Regulation § 38.852 attempts to mitigate conflicts of interest by allowing an affiliated principal trading firm to trade as principal provided that the DCM complies with certain procedural guardrails.[17] These guardrails include requirements that a DCM must: (i) ensure that its matching system does not favor the affiliate and that the affiliate's orders are filled last at every price level; (ii) bind the affiliate to a market-making program requiring continuous two-sided quotations, minimum trading hours, and bid-ask spread limits, and prohibiting directional proprietary positions, with program terms no less favorable to the DCM than those offered to unaffiliated members in a comparable program; (iii) offer any incentive program to unaffiliated members on terms no less favorable than those offered to the affiliate; (iv) designate an independent third-party regulatory service provider ("RSP") to monitor the DCM's compliance with its conflicts procedures and to certify compliance annually; and (v) deliver a disclosure of the affiliate relationship before a customer's first order each session.[18] The Commission explained that it preliminarily declined to propose a flat prohibition on affiliate market making, in part because an outright prohibition would be the most disruptive alternative and could leave new markets too thin.[19]

Sporttrade supports the Commission's efforts to address the conflicts arising from entities trading on affiliated exchanges. However, these behavioral guardrails are rendered completely ineffective by the elementary fee-structure loophole detailed below.

B. The Economic Mechanism of Exchange Fee Arbitrage

The Commission recognized that an exchange controls the terms on which participants trade, including the fees and incentives available to liquidity providers, and that affiliation gives the exchange a direct financial incentive to set those terms to advantage

[16] 91 Fed. Reg. at 50932.
[17] *Id.* at 50992.
[18] *Id.*
[19] *Id.* at 50953.

its affiliate.[20] The illustration below shows how a fee schedule that is uniform on its face can do exactly that, without running afoul of any condition in proposed § 38.852 as drafted.

Consider a DCM listing binary event contracts with $1.00 payouts. Suppose the DCM implements a flat exchange fee of **$0.03 per contract** applicable to all market makers on paper.

1. **Impact on Unaffiliated Market Makers:** To cover exchange fee friction ($0.03 to buy and $0.03 to sell = $0.06 total round-trip fee), an independent market maker must maintain a bid-ask spread of **at least $0.07** (e.g., bidding $0.44 and offering $0.51) just to retain a net profit spread of $0.01 per contract. Quoting a tighter spread (such as $0.47 bid / $0.49 offer) results in a net economic loss of $0.04 per contract executed on a round-trip basis. Unaffiliated market makers cannot sustainably provide liquidity under this fee structure and will withdraw from the venue.

2. **Impact on the 100%-Owned Affiliate Market Maker:** The DCM's 100%-owned affiliate market maker can bid $0.47 and offer $0.49, knowingly absorbing a $0.04 paper loss per contract. This is because every dollar paid in exchange fees by the 100%-owned affiliate moves directly from the affiliate's left pocket into the DCM parent's right pocket.

On a consolidated corporate basis, the net cost of the exchange fee to the parent entity is zero ($0.00). The 100%-owned affiliate can continuously run on paper losses, capturing $0.02 of market spread while transferring $0.06 in nominal fees to its exchange parent.

Through this internal accounting transfer, the DCM uses its fee schedule as an anti-competitive weapon to choke out all independent liquidity providers. The DCM has clear incentives to do so. It forgoes the fee revenue it would have earned from independent market makers, but in exchange its corporate group captures the spread. Once rivals have exited, the group is free to widen the spread toward the point that maximizes the house edge. Economic literature describes this class of strategy as raising rivals' costs and vertical foreclosure, and competition authorities have long treated a vertically integrated firm's ability to disadvantage rivals that depend on its inputs as a central competitive concern.[21]

C. Why the Proposed Guardrails Cannot Prevent This Exploitation

[20] *Id.* at 50949.

[21] *See* Steven C. Salop & David T. Scheffman, *Raising Rivals' Costs*, 73 Am. Econ. Rev. 267 (1983); Janusz A. Ordover, Garth Saloner & Steven C. Salop, *Equilibrium Vertical Foreclosure*, 80 Am. Econ. Rev. 127 (1990); U.S. Dep't of Justice & Fed. Trade Comm'n, Merger Guidelines, Guideline 5 (2023).

Each proposed guardrail is directed at how an affiliate behaves once it is trading alongside other participants.[22] As shown below, each guardrail therefore leaves the exchange fee arbitrage mechanism described in Section II.B intact.

- **Order Subordination (§ 38.852(c)(1)(i)):** The Proposed Rule would require a DCM to ensure that its trade matching system does not favor the affiliate market maker, by filling the bid or offer of any unaffiliated member before the affiliate's bid or offer at the same price, regardless of time priority, so that the affiliate's bids and offers are filled last at every price level.[23] Subordinating the affiliate's orders to unaffiliated orders at the same price tick is meaningless if the exchange fee structure prevents unaffiliated market makers from quoting at that price tick in the first place. The affiliate's quote remains the *only* competitive quote on the order book. Subordinating an affiliate to zero competitors achieves nothing.

- **Incentive Parity (§ 38.852(b)(2)):** The Proposed Rule would require a DCM that offers an incentive or similar program filed under Part 40 that applies to affiliate principal trading firms to have procedures ensuring that unaffiliated members can participate in the program on terms no less favorable than those offered to the affiliate.[24] Mandating that fee and incentive programs be offered to non-affiliates on "terms no less favorable" fails because a high flat fee is applied equally on paper. Equal treatment of unequals is inherently discriminatory when the exchange parent recovers 100% of the fee from its affiliate.

- **Independent Verification & Disclosures (§ 38.852(c)(2)–(3)):** The Proposed Rule would require a DCM that permits an affiliate market maker to trade to designate an independent third-party RSP to conduct financial surveillance of the affiliate, to review and monitor the DCM's compliance with its conflicts-of-interest procedures, and to certify annually to the Commission and the DCM's board that the affiliate satisfies the proposed conditions and that the DCM is complying with its procedures.[25] It would also require the DCM to disclose the affiliate relationship, and the conditions imposed on the affiliate, to each customer on a per-session basis before the customer first enters an order.[26] An independent RSP auditing the DCM will confirm that the high fee schedule is published transparently and applied neutrally to all market participants. Disclosures will accurately state that fees apply to everyone. Neither an RSP nor a point-of-session pop-up notice can fix the underlying corporate accounting reality that renders the fee non-viable for non-affiliates. A customer who is told that the exchange has an affiliated market maker is given no ability to change the market structure that results.

[22] *See* 91 Fed. Reg. at 50953.
[23] *Id.* at 50992.
[24] *Id.*
[25] *Id.*
[26] *Id.*

III. THE SOLUTION: A MANDATORY 20% OWNERSHIP CAP ON MARKET-MAKING AFFILIATES

A. Proposed Rule Text Amendment (§ 38.852(c)):

To eliminate exchange fee arbitrage, protect retail participants, and fulfill the statutory mandates of DCM Core Principles 9 and 16, Sporttrade reiterates the recommendation first set forth in our RIN 3038-AF65 comment letter:[27] **the Commission should amend proposed § 38.852 to include a strict structural equity restriction. Specifically, Sporttrade proposes that the Commission add the following to § 38.852(c):**

> *No Designated Contract Market (or parent entity or holding company thereof) shall hold, directly or indirectly, a beneficial ownership interest exceeding **20%** (on a fully diluted basis) in any market maker, liquidity provider, or principal trading firm permitted to trade on or provide liquidity to such Designated Contract Market.*

If this language were adopted, a firm in which the DCM holds more than a 20% interest could not trade on the DCM. This would not, however, be the outright prohibition on affiliate principal trading that the Commission considered and preliminarily declined to propose.[28] A DCM could continue to hold up to a 20% interest in a market maker, could contract with any number of unaffiliated market makers, and could use market-making programs open to all to support liquidity.

B. How the 20% Ownership Cap Restores True Competition

A 20% ownership cap immediately realigns corporate incentives and eliminates the fee-arbitrage loophole.

1. **Real Economic Loss:** If a 20%-owned affiliate pays $0.06 in exchange fees to capture $0.02 of spread (losing $0.04), the $0.04 loss is no longer an internal accounting transfer. **80% of that loss ($0.032) is borne by outside investors**, while the DCM parent only recovers 20% ($0.008) via the exchange fee.

2. **Elimination of Predatory Loss-Leaders:** Running the affiliate as a subsidized loss-leader to choke out independent market makers becomes economically unviable and represents real, unrecoverable capital destruction for the affiliate's equity holders.

3. **Natural Price Discovery for Exchange Fees:** To attract liquidity, the DCM is forced to set exchange fee schedules at realistic, competitive levels (approaching

[27] Sporttrade Inc., Comment Letter on Proposed Rule on Prediction Markets; Public Interest Determinations, *supra* note 2.
[28] 91 Fed. Reg. at 50953.

zero or marginal cost) that allow independent, unaffiliated market makers to compete sustainably.

By imposing this structural limit, the effective maximum fee structure a DCM can charge becomes competitive, introducing the market forces necessary to truly make a DCM an open, multilateral Board of Trade. This limit would thus advance the considerations the Commission must weigh under CEA Section 15(a), including the protection of market participants, the efficiency and competitiveness of futures markets, and price discovery.[29]

IV. CONCLUSION

Behavioral guardrails alone cannot overcome the financial incentives of consolidated 100% corporate ownership. If the CFTC permits DCMs to hold 100% equity stakes in venue market makers, exchange fee schedules will be weaponized to exclude independent liquidity, transforming public contract markets into private single-dealer sportsbooks. The Proposed Rule's guardrails are a sound foundation, but they regulate conduct inside a fee structure that a vertically integrated DCM can still set to its own advantage.

Sporttrade urges the Commission to adopt a **20% structural ownership cap** on DCM market-making affiliates in the finalized Part 38 regulations. This standard will eliminate fee-arbitrage loopholes, protect retail consumers, foster innovation, and ensure that CFTC-regulated exchanges remain open, competitive, and transparent Boards of Trade.

Respectfully submitted,

/s/ Alexander Kane

Alexander Kane

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[29] 7 U.S.C. § 19(a)(1)–(2); 91 Fed. Reg. at 50970.